Supreme Court of the United States

OCTOBER TERM, 1956.

No. [redacted] 14

JOSEPH F. BLACK, ASSISTANT REGIONAL COMMISSIONER ALCOHOL AND TOBACCO TAX DIVISION (DALLAS REGION), INTERNAL REVENUE SERVICE,

Petitioner,

versus

MAGNOLIA LIQUOR COMPANY, INC.,

ANSWER TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT.

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MAGNOLIA LIQUOR CO., INC. prays that the application for a Writ of Certiorari to review the judgment of the United States Court of Appeals for the Fifth Circuit, entered in this matter, be denied for the reasons hereinafter set forth:

QUESTION PRESENTED.

Whether Section 5(a) and 5(b) of the Federal Alcohol Administration Act[1] can be interpreted as prohibiting the practice of "tie-in sales" between a wholesaler and retailer of alcoholic beverages.

STATUTES INVOLVED.

This matter concerns an interpretation of Sections 5(a) and 5(b) of the FAA Act, but in addition thereto the imposition of civil sanctions and criminal penalties as provided in the Act.

Section 5 of the Federal Alcohol Administration Act has been set forth in full in the application for writs. The penal Sections have not been discussed. Violation of 27 U.S.C. 205 may result in both civil penalties in the form of a revocation or suspension of a basic permit to operate as a wholesaler (27 U.S.C. 204), or criminal prosecution (27 U.S.C. 207).[2]

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[1] 49 Stat. 977, 27 U.S.C. 205.

[2] The Civil procedure is outlined in Footnote (3), Page 4 of the petition. 27 U.S.C. 207 provides that a conviction for violation of the statute may result in penalty of $1,000.00 for each offense. This statute is quoted in full in the Appendix.

STATEMENT OF THE CASE.

Proceedings were instituted against MAGNOLIA LIQUOR CO., INC., charging it with violation of Section

5 of the Act in requiring certain named customers to purchase gin, Seagram's 7-Crown blended whiskey, or cordials in order to obtain Johnny Walker Scotch whiskey or Seagram's V. O. Canadian whiskey, and certain record-keeping infractions. Sales so made are referred to as "tie-in sales". The examiner recommended a suspension of Magnolia's permit for 45 days. An appeal was taken to the Director of the Alcohol and Tobacco Tax Division of the Internal Revenue Service, who affirmed the findings as to the tie-in sales violation and reversed the examiner on the infraction of the record keeping requirements. The Director reduced the period of suspension to 15 days. The Assistant Regional Commissioner issued a suspension order from which appeal was taken. The Court of Appeals for the Fifth Circuit reversed the decision of the Assistant Regional Commissioner and dismissed the charges.

MAGNOLIA LIQUOR CO., INC. is the exclusive wholesale distributor in New Orleans for Seagram Distillers Corporation. Of twenty-eight retail liquor dealers interviewed by a Special Investigator of the Alcohol and Tobacco Tax Division, eight were called as witnesses. Of these, seven gave testimony from which the Examiner found that they had bought plentiful items in order to get the scarce items. The Investigator testified that, in his effort to ascertain whether Magnolia Liquor Co., Inc. was tieing V. O. with gin and other products, he picked out isolated invoices for the purpose of demonstrating a pattern. Some of the witnesses testified that they had to buy Seagram's 7-Crown whiskey or Seagram's gin to get V. O. or Johnny Walker. One witness said he was re-

quired to buy Seagram's gin in order to get 7-Crown. During the period involved, December, 1950, January, February and March, 1951, the said Magnolia Liquor Co., Inc. sold 7,067 cases of V. O., 29,049 cases of 7-Crown and 2,050 cases of Seagram's gin. The volume of these items in the so-called tie-in sales was 26 cases of V. O., 5 cases of Scotch, 64¼ cases of 7-Crown and 12 cases of gin.[3]

REASONS URGED FOR DENYING WRITS.

1. The decision in the Court below is not in conflict with the decision of the Court of Appeals for the Second Circuit in *Distilled Brands vs. Dunigan*, 222 Fed. 2d, 867, but augments it.

2. The decision of the Court below is correct.

I.

There is no conflict between the decision of the Fifth Circuit Court of Appeals in this case and the decision of the Court of Appeals for the Second Circuit in the *Distilled Brands* case. Any conflict between these two cases is more apparent than real. The *Distilled Brands* case held on the facts before it, that the tie-in sales committed were prohibited by Sections 5(a) and 5(b) of the Federal Alcohol Administration Act. In the *Magnolia* case the Fifth Circuit had before it *additional* relevant facts relat-

[3] This is, with adoptive editing, the statement of the case, adopted by the Fifth Circuit Court of Appeals in its decision. Magnolia Liquor Co., Inc. vs. Cooper, 231 F.2d, 941, at Page 942.

ing to the statute itself, and the Court below found that the *Distilled Brands* case was correct—based upon the information before that Court—but that with the additional information available, a further examination of the statute was warranted, and a different result was proper.

The Court in the *Distilled Brands* case disposed of the statutory interpretation question relating to Section 5 of the Act, with these two brief comments:

> "We agree with the position of the Division that tie-in sales do constitute a sufficient interference with competition to require prohibition within the regulatory scheme of the Federal Alcohol Administration Act, and that Section 5, 27, U.S.C., Section 205, actually covers such transactions . . . . ."

> "The broader reading given to Section 5 by the administrative tribunal below is in accordance with the construction put thereon by the Treasury Department since 1946. This construction is of considerable weight, particularly when it is so eminently reasonable in the light of the over-all purposes of this regulatory statute . . . ."

The entire decision of the Court below was devoted to a discussion of the statute involved: its language, its captions and its history, and with reference to the *Distilled Brands* decisions, the Court said:

> "The opinion in DISTILLED BRANDS v. DUNIGAN, SUPRA, gives to Section 5 the 'broader reading' of the administrative tribunal, and finds such to be in accord with 'the construction put thereon by the Treasury Department since 1946'. Since it does not appear from the opinion in the Distilled Brands

case that the letter of the Acting Secretary was before the court, we assume that the court was entitled to find from the evidence before it that there had been a continuous and confident administrative construction consonant with its contention there and here asserted."

The *Distilled Brands* decision was predicated upon the legal proposition that there was a consistent and unequivocal construction of the Act by the Treasury Department, entitled to considerable weight. The additional information before the Court in this case conclusively showed that the administrative construction was neither confident nor consistent (as was assumed by the Court in the *Distilled Brands* case) and, therefore, the rationale of the *Distilled Brands* case was completely refuted.

II.

When the repeal of prohibition became effective, Congress was not in session. The regulation of the liquor industry was then accomplished by the Codes of Fair Competition, adopted under the provisions of the National Industrial Recovery Act. Section 5 of the Codes, relating to alcoholic beverages contained provisions for prohibited agreements by wholesalers from exacting or requiring that any retailer handle or sell only the products of a particular member of the industry. When the N.I.R.A. was declared unconstitutional, the Federal Alcohol Administration Act was passed and most of the practices outlawed by the Codes of Fair Competition were brought within the scope of the Federal Alcohol Ad-

ministration Act. Such was the express object and purpose of this legislation:

> "The bill [Federal Alcohol Administration Act] embodies in statutory form so much of the former code system as the committee now deems appropriate and within the constitutional power of Congress to enact. In general, it may be said that the bill incorporates the greater part of the system of Federal control which was enforced by the Government under the codes." H. R. Rep. No. 1542, 74th Cong. 1st Sess. (1935); Senate Report No. 1215.

From this background emerged among other provisions, Section 5(a) and 5(b) of the FAA Act, prohibiting as the captions of the statute itself provide, "Tied House" and "Exclusive Outlet".

If we turn to the declarations of the Congress when the FAA Act was under discussion, we find that these are the definitions of the practices contemplated by Sections 5(a) and 5(b) of the Act: [4]

> SECTION 5(a): "TIED HOUSE—that is, a situation where a retailer had to take a certain quota of some private brand as a condition to being allowed to retail that brand;" or
>
> SECTION 5(b): "EXCLUSIVE OUTLET—that is, a monopolistic control of that retail outlet to the absolute exclusion of all other brands."

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[4] **In their sessions, the Congress discussed and defined the particular unfair trade practices which they proposed to strike down by Sections 5(a) and 5(b) of the FAA Act. Quotation of this language is found in the Appendix, INFRA.**

"Tie-in sales", as defined in this case, were not contemplated.

However, during and after the last war, economic circumstances created shortages in certain lines of alcoholic beverages and a practice emerged whereby certain wholesalers required a retailer to purchase both plentiful and short items in order that the retailer could not deplete the stock of the short items by their purchases only, and ignore the other products sold by the wholesaler. This is the practice known as "tie-in sales"—a practice which this Court in *Federal Trade Commission vs. Gratz* [5] held was not illegal *per se:*

> "All questions of monopoly or combination being out of the way, a private merchant, acting with entire good faith, may properly refuse to sell except in conjunction, such closely associated articles as ties and bagging. If real competition is to continue, the right of the individual to exercise reasonable discretion in respect to his own business methods must be preserved."

In 1946 the Treasury Department issued rules to show cause, addressed to substantially all the wholesalers of the country (including Magnolia Liquor Co., Inc.). All of these show cause orders were dismissed by stipulation; none were brought to trial. In 1947 the Acting Secretary of the Treasury addressed a letter to the President *Pro tempore* of the Senate, outlining the circumstances relating to these stipulations and expressing the doubt of the

[5] 253, U.S. 421, 40 Sup. Ct. 572 (1920).

Treasury Department as to whether Sections 5(a) and 5(b) prohibited tie-in sales:

> "The Department reached the conclusion that such practices [tie in sales] violated the provisions of Sections 5(a) and 5(b) of the Act (U.S.C. title 27, secs. 205(a) and 205(b) where the transactions were of a nature to affect interstate or foreign commerce. *In the absence of a provision in the statute expressly dealing with 'tie in' sales*, however, it was decided to institute proceedings for the revocation or suspension of the basic permits of suppliers instead of attempting criminal prosecutions. Such proceedings were instituted in numerous cases, with the result that many suppliers agreed in writing to discontinue such practices. *This disposition of the cases was due to doubt on the part of the Department as to whether violations of the statute could be established through the 'tie-in' sales.* It was contended by members of the industry that 'tie-in' sales were not within the purview of sections 5(a) and 5(b) and that those sections were designed to prevent the creation of exclusive outlets and tied houses only. In a view of the situation it is believed that the Act should be so amended as definitely to vest the Department with authority to act in such cases. It is proposed to accomplish this result by adding at the end of Section 5(c) a new clause as follows:
>
> "'(c) by conditioning the purchase with the purchase of any other distilled spirits, wine or malt beverages; or;'
>
> "This proposed amendment has been tacked on to section 5(c) of the Act for the reason that the prohibitions of this section, unlike those of sections 5(a) and 5(b) run to transactions with any 'trade buyer',

which term as defined in the Act includes wholesaler and retail dealers." Cong. Record. November 17, 1947, p. 10690, dated Aug. 15, 1947. (Emphasis ours.)

On two occasions bills were introduced into Congress which would have expressly prohibited tie-in sales; neither measure passed.

From the date of the letter by the Treasury Department to the Senate and the rejection of the proposed legislation, the Treasury Department was silent on this question.

The proposed legislation would have added a third paragraph to Section 5 of the FAA Act and we collate for you the language of the statute as originally enacted and as proposed:

27 U.S.C.A. 205(a) and (b)	Proposed Amendment to 27 U.S.C.A. 205 (c)
205. **Unfair competition and unlawful practices**	
It shall be unlawful for any person engaged in business as a . . . wholesaler, of distilled spirits, wine, or malt beverages. . . .	It shall be unlawful for any person engaged in business as a wholesaler of distilled spirits, wine or malt beverages.
(a) **Exclusive outlet.** To require, by agreement or otherwise, that a retailer engaged in the sale of distilled spirits, wine, or malt beverages, purchase any such products from such person	(c) **Commercial Bribery.** To induce any trade buyer engaged in the sale of distilled spirits, wine or malt beverages to purchase any such products from such person; . . .

to the exclusion in whole or in part of distilled spirits, wine, or malt beverages sold or offered for sale by other persons in interstate or foreign commerce . . .

(b) **"Tied house".** To induce through any of the following means any retailer, engaged in the sale of distilled spirits, wine, or malt beverages, to purchase any such products from such person to the exclusion in whole or in part of distilled spirits, wine, or malt beverages sold or offered for sale by other persons in interstate or foreign commerce. . . .(7) by requiring the retailer to take and dispose of a certain quota of any of such products; . . . or (3) by conditioning the purchase of any distilled spirits, wine or malt beverages upon, or "tying in" such purchase with the purchase of any other distilled spirits, wine or malt beverages.

The Treasury Department, the Second Circuit Court of Appeals, and the Court below concluded that Sections 5(a) and 5(b) of the Federal Alcohol Administration Act did not *expressly* prohibit the practice of "tie-in sales"; thus, the issue presented was the interpretation of Sections 5(a) and 5(b) of the FAA Act. The Court below, in finding that Sections 5(a) and 5(b) of the FAA Act did not prohibit tie-in sales, considered these elements of statute interpretation: the actual language of the statute, the captions to the applicable sections, the penal nature of the statute, its legislative history:

1. The Act does not expressly prohibit tie-in sales.

2. Tie-in sales were not among the practices included in the Codes and contemplated by the Congress when the FAA Act was adopted.

3. Although the Treasury Department originally advanced an interpretation to the effect that tie-in sales were contrary to the Act, it clearly abandoned this position:

a) All prosecutions were dismissed by stipulation, which stipulation in our case expressly provided that it should not prejudice the rights of Magnolia Liquor Co., Inc. in any subsequent proceedings. No other action was taken from 1946 to 1952.

b) It addressed a communication to the Congress, declaring to Congress and to all concerned that it had doubts as to the applicability of the statute.

c) It unsuccessfully sought additional legislation to clarify the point, using the precise language which the Department sought to read into Sections 5(a) and 5(b) of the Act.

4. Thus, there was no clear and confident administrative construction of the statute or course of action which would be entitled to "great weight" afforded this erroneous assumption by the Second Circuit in the *Distilled Brands* case.

5. An alleged violation of Sections 5(a) and 5(b) involves not only civil proceedings, as is this case, but likewise includes criminal responsibility. Such a statute is, therefore, penal in its nature and should be strictly construed.[6]

Considering these factors, the Court below resolved all doubt in the interpretation of this statute in favor of Magnolia Liquor Co., Inc. and against the Treasury Department and reversed the decision of the Acting Commissioner of Internal Revenue. This decision is manifestly correct.

OTHER CONTENTIONS.

We invite the attention of the Court to the following language in the opinion in this case:

"The appellant, in addition to its contention that tie-in sales are not prohibited by the Act, urges other grounds for reversal. Some of these, we think, have

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[6] United States v. Wiltberger, 5 Wheat. 76, 5 L.Ed. 37. See Tiffany v. Missouri National Bank, 18 Wall. 409, 21 L.Ed. 862; Providence Steam Engine Co. v. Hubbard, 101 U. S. 188, 25 L.Ed. 786. The Government throughout its argument (and the Court below as well) have continuously by-passed the criminal penalties involved under Section 7 of the F.A.A. Act. The choice of civil or criminal procedure, or even both, is left entirely within the discretion of the Treasury Department.

merit but the view which we have taken makes a determination of them unnecessary."

These contentions, as outlined by the Court below, are as follows:

1. That tie-in sales have not been proved;

2. That the proof does not show a practice of tie-in sales "to such an extent as substantially to restrain or prevent transactions interstate or foreign commerce";

3. That there was no "willful" violation of the Act;

4. That the suspension of appellant's permit constituted a taking of property without due process of law;

5. That the regulation of trade practices between a wholesaler and retailers of alcoholic beverages violates the Twenty-first Amendment to the United States Constitution; and

6. The sanction imposed is excessive.

It is respectfully submitted that if the Court should disagree with the position taken above, that the matter should be remanded to the Court of Appeals so that all of the issues can be decided by that Court and the matter presented to the Supreme Court on one, and not on several occasions.

CONCLUSION.

The decision below is not in direct and express conflict with that of another Court of Appeals but is based upon the examination of additional facts which warrant the conclusion reached by the Court below, and its decision is correct as to the interpretation of the Federal Alcohol Administration Act.

It is, therefore, respectfully submitted that the petition for a Writ of Certiorari should be denied.

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CERTIFICATE.

I hereby certify that copies of this answer have been served on opposing counsel this 20 day of September, 1956.

APPENDIX.

1. 27 U.S.C. 207:

PENALTIES; JURISDICTION; COMPROMISE OF LIABILITY.

The District Courts of the United States, and the United States court for any Territory, of the District where the offense is committed or threatened or of which the offender is an inhabitant or has his principal place of business, are hereby vested with jurisdiction of any suit brought by the Attorney General in the name of the United States, to prevent and restrain violations of any of the provisions of this chapter. Any person violating any of the provisions of section 203 or section 205 of this title shall be guilty of a misdemeanor and upon conviction thereof be fined not more than $1,000 for each offense. The Secretary of the Treasury is authorized, with respect to any violation of this chapter, to compromise the liability arising with respect to such violation (1) upon payment of a sum not in excess of $500 for each offense, to be collected by the Secretary and to be paid into the Treasury as miscellaneous receipts, and (2) in case of repetitious violations and in order to avoid multiplicity of criminal proceedings, upon agreement to a stipulation that the United States may, on its own motion upon five days' notice to the violator, cause a consent decree to be entered by any court of competent jurisdiction enjoining the repetition of such violation.

2. The following are excerpts from the several discussions of the provisions of Section 5 of the Federal Alcohol Administration Act in Congress:

HOUSE REPORT NO. 1542:

"Under the code system a voluntary code for the brewing industry (already in existence at the time of repeal as a result of 3.2 beer legislation of March 22, 1933) was approved by the President. At the same time, the President imposed codes upon the other alcoholic beverage industries, namely, the distillers, rectifiers, importers, wholesalers, and wine producers. By Executive order under the National Industrial Recovery Act the President established the Federal Alcohol Control Administration to administer these codes and certain related functions. *The bill embodies in statutory form so much of the former code system as the committee now deems appropriate and within the constitutional power of Congress to enact. In general, it may be said that the bill incorporates the greater part of the system of Federal control which was enforced by the Government under the codes.*"

SENATE REPORT NO. 1215:

"The bill embodies in statutory form so much of the former code system as the committee now deems appropriate and within the constitutional power of Congress to enact. In general, it may be said that except with respect to malt beverages the bill as amended by the committee incorporates the greater part of the system of Federal control which was enforced by the Government under the codes."

CONGRESSIONAL RECORD, VO. 79, NO. 152, P. 12270:

"Mr. Lewis, of Colorado. Mr. Chairman, this is a further restriction on the so-called 'tied house', which

is regulated under section 5(b) of this bill. Before prohibition, in our part of the country at least, one of the evils of the liquor traffic was that a retailer was required by the brewer or distiller to take a certain quota of beer or spirits of some private brand as a condition to being allowed to retail that brand. The temptation was often irresistible for the retailer to induce customers to buy drinks when they had already had quite enough. This was a very great evil, as I believe the members of the committee will concede. I think this is an important amendment to this bill. I hope the committee will accept the amendment."

HOUSE REPORT 8870—The Committee on Finance:

"The tied-house provisions, it should be noted, relate to the *acquisition by industry members of control over theretofore independent retail establishments and do* not prohibit industry members from continuing to operate retail outlets heretofore established by them and wholly owned and operated by them, nor the establishment by industry members of new retail outlets of such character."

Both committees reporting on HOUSE REPORT 8870 carefully explained the purposes of Section 5:

"These prohibited practices fall in two general categories, those relating to *monopolistic control* of retail outlets and those relating to labeling and advertising."

"The House Bill (Sec. 5) prohibited 2 classes of trade practices. The first class of these prohibited practices

were those which tended to produce monopolistic control of retail outlets, such as arrangements for *exclusive outlets*, creation of *tied houses*, commercial bribery, and sales on consignment with privilege of return. * * *

"The second class of unfair practices prohibited by the bill are those relating to false labeling and false advertising * * *".

The Ways and Means Committee said clearly:

"Three other types of practices which are closely related to, and have *constituted additional means of effecting, the 'tied house'* are also prohibited. These *practices are exclusive* purchase agreements with retailers (sec. 5(a)); commercial bribery of a trade buyer, or the offering or giving of any bonus, premium or compensation to the officers or employees of a trade buyer (sec. 5(c)); and deliveries to a trade buyer on consignment or conditional sales, or sales with the privilege of return, or sales on any basis other than a bona-fide sale (sec. 5(d))."

"The foregoing practices have in this industry constituted the principal abuses whereby interstate and foreign commerce have been restrained and *monopolistic control* has been accomplished or attempted. The most effective means of preventing monopolies and restraints of trade in this industry is by prohibiting such practices, thereby striking at the causes for restraints of trade and *monopolistic conditions* and dealing with such conditions in their incipiency. "Furthermore, such abuses were so prevalent before prohibition that they were regarded in a large

measure as responsible for the evils which led to prohibition. (See Report of the National Commissioner on Law Observance and Enforcement (1931), H. Doc. No. 722, 71st Cong., 1st sess., p. 6' and Fosdick and Scott, Toward Liquor Control (1933), pp. 42-43.) The prohibition of these practices will, accordingly, not only *prevent monopoly* and restraint of interstate trade but will also tend to eliminate or mitigate certain incidental social evils, such as those which have necessarily followed the forced increase in alcoholic-beverage sales resulting from the 'tied-house'."